Trial to Amplify the Citi-EMI Discord

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By Peter Lattman
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Guy Hands and David Wormsley once made beautiful music together.

For more than a decade, Mr. Hands, pictured, the flamboyant British financier, struck prominent deals and Mr. Wormsley, a star banker at Citigroup in London, advised on them. They made piles of money and became close friends, and accompanied each other to the opera.

In May 2007, Mr. Hands made the most audacious bet of his career. His firm paid $6.7 billion for the EMI Group, the record label that carried the Beatles and Frank Sinatra. Mr. Wormsley auctioned off the company, and Citigroup provided about $4.3 billion in loans to finance the deal.

Then the music stopped.

On Monday, Mr. Hands and Mr. Wormsley will face off in a federal courtroom in Manhattan. Barring an 11th-hour settlement, a six-person jury will decide the outcome of a lawsuit brought by Mr. Hands's private equity firm against Citigroup over its role in EMI's sale. Mr. Hands accuses his once-trusted adviser of deceiving him during the auction process.

At the trial, Citigroup's lawyers are expected to depict his lawsuit as a Hail Mary pass to try to salvage a failed investment and portray Mr. Hands as having a classic case of buyers' remorse.

Representatives for the bank say that it has done nothing wrong, and that the case is a negotiating tactic by Mr. Hands. Citigroup, which still owns all of EMI's loans, has for more than a year been locked in restructuring talks with Mr. Hands over the fate of EMI, which is suffocating from plummeting recorded music sales and its heavy debt load.

"Bringing a lawsuit is a common strategy to employ in order to gain leverage in a negotiation," said Guhan Subramanian, a professor of law and business at Harvard whose recent book "Negotiauctions" (W..W. Norton & Company) examines complex deal-making situations. "Even though Citigroup believes this is a frivolous lawsuit, it's risky to expose itself to the uncertainties surrounding the wild card of a jury trial."

EMI has become Exhibit A for the handful of overpriced boom-era acquisitions that have since turned sour.

Mr. Hands's purchase of EMI was by far the largest deal his firm, Terra Firma Capital Partners, had ever struck. He wagered nearly one-third of the firm's $7.7 billion fund on EMI. He and his partners invested about $290 million of their own money.

It was to be the capstone acquisition for Mr. Hands, 51, a former Goldman Sachs banker educated at Oxford who, unlike many private equity barons, relished the limelight. He set about

trying to turn around the 113-year-old music company that houses blockbuster acts like Katy Perry, Coldplay and Keith Urban.

Things haven't worked out. While Mr. Hands has been able to slash costs and revenue has recently picked up, EMI remains a sickly business. Several major acts have left the record label since Mr. Hands took over, including Radiohead and the Rolling Stones. Terra Firma has written down the value of its EMI investment to zero and has had to inject about $150 million into the company to keep it afloat.

Citigroup has a vested interest in EMI's fate. The bank could not sell EMI's loans to other investors when the credit markets collapsed, forcing the bank to retain $4.3 billion of the company's debt on its books. It has played hardball with Mr. Hands, rejecting his proposals to restructure the company's overleveraged balance sheet.

EMI, which continues to face serious financial problems, is still at risk of defaulting on its debt. If it does, Citigroup could wrest control of EMI and sell it off once again. Despite its woes, EMI would be highly coveted, particularly its profitable music publishing arm.

The trial is expected to open a window into the frenzied deal-making that occurred at the peak of the buyout craze — as well as its ugly aftermath. It will center on the final days of Citigroup's harried auction of EMI. Although a number of investment firms expressed interest in acquiring the company, Terra Firma was the only bidder. Mr. Hands has accused Mr. Wormsley, his once-trusted adviser, of lying about that.

He says that Mr. Wormsley unfairly drove up the auction price by misrepresenting that there was another bidder for the company.

The case hinges on three telephone conversations during which Mr. Hands said that Mr. Wormsley told him that Cerberus Capital Management, the New York investment firm, had also bid for EMI. This caused Terra Firma to increase its bid.

In his deposition, Mr. Wormsley, 50, who is affectionately known as "the Worm" in London banking circles, said he did not know that Cerberus had changed course and decided to drop out of the auction. He said that he "had no knowledge of the status of Cerberus's bid, indeed not the blindest bit of thing about it."

Terra Firma seeks to recover about $8 billion in damages, as well as punitive damages, for what it calls Citigroup's "egregious wrongdoing."

The case has had several entertaining subplots, including a battle over the trial's location. This year Citigroup tried to move the case to London, arguing that the main players in the dispute and many of the events surrounding the deal took place there.

Shifting the case to London could have jeopardized Mr. Hands's status as a British tax exile. In April 2009, Mr. Hands fled Britain and its rising tax rates and now lives on the island of Guernsey, a tax haven just off of France's coast.

Judge Jed Rakoff, who will preside over the trial, denied Citigroup's motion and kept the case in New York.

The case will feature a couple of prominent trial lawyers. David Boies of Boies, Schiller & Flexner, is representing Mr. Hands and Terra Firma. Defending Citigroup is Theodore V. Wells Jr., a partner at the law firm of Paul, Weiss, Rifkind, Wharton & Garrison.

Their courtroom showdown comes just a year after Mr. Boies and Mr. Wells battled each other before Judge Rakoff. In that case, Mr. Boies successfully defended Maurice R. Greenberg in a breach-of-trust lawsuit brought by Mr. Wells's client, the American International Group.